OCT 4 1951

IN THE

Supreme Court of the United States

NO. 367

ACF-BRILL MOTORS COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

ACF-Brill Motors Company by its counsel, John E. Hughes, John W. Hughes and Harold R. Burnstein, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Third Circuit entered in this case.

Opinions Below.

The opinion of the Tax Court (R. 63a) is reported in 14 TC 263. The opinion of the Court of Appeals (R. 87) is reported in 189 F. 2d 704.

Jurisdiction.

The judgment of the Court of Appeals was entered on June 7, 1951 (R. 92). A petition for rehearing was filed on June 21, 1951 and was denied, without opinion, on July 11, 1951 (R. 99). The jurisdiction of this Court is invoked under Section 1254(e) of Title 28, United States Code.

Question Presented.

When American Car & Foundry Securities and Brill bought the stock of Hall-Scott Motor Car Company for $3,000,000 with the purpose (admitted by respondent in his brief in the Court below) of organizing taxpayer and transferring that stock to it, by carrying out such purpose they clearly invested $3,000,000 in the taxpayer. The theory of the invested capital credit for excess profits tax is that a corporation is entitled to earn from 5 per cent to 8 per cent of the investment made in the corporation by its stockholders before any of its profits are treated as "excess." By breaking the one transaction into two steps and giving each step separate tax effects, the decision below allows the taxpayer to include in its invested capital only $100,000 for all the Hall-Scott stock acquired by it for $3,000,000.

The question presented is whether a complicated corporate reorganization effected in a number of steps should be treated as one transaction or broken up into its separate steps and each be given separate tax effects.

Statutes And Regulations Involved.

The statutes and regulation involved are printed in the Appendix, pages 13 to 14.

STATEMENT.

Petitioner is the successor by merger of American Car and Foundry Motors Company (hereinafter referred to as the taxpayer) with the Brill Corporation. Taxpayer filed consolidated corporation income and excess profits tax returns under the provisions of Section 141 of the Internal Revenue Code for the calendar year 1943 on behalf of itself and its wholly-owned subsidiaries which included Hall-Scott Motor Car Company and Fageol Motors Company. (R. 64a-65a)

In the year 1925 it became apparent to the officers of American Car & Foundry Company, a manufacturer of railroad cars and equipment, and the J. G. Brill Company, a manufacturer of interurban and street railway cars, that the street railway business was on the downgrade and that the manufacture and sale of buses was becoming increasingly important. Hence, W. H. Woodin, president of American Car and Foundry Company, and S. M. Curwen, president of the J. G. Brill Company, became interested in the manufacture of buses. They commenced activities to procure that type of business almost immediately. (R. 65a)

The bus manufacturing business required two things, the ownership of a good engine and the ownership of the necessary skill, technique and plant required for the manufacture of bus bodies. Neither the American Car & Foundry Company nor the J. G. Brill Company had any experience in the manufacture of either a bus engine or a bus body. The plan was to enter the bus manufacturing business through the purchase of both a manufacturer of an engine and a manufacturer of bus bodies.

In June, 1925 Woodin and Curwen commenced negotiations to acquire the assets or the controlling interest of stock of the Hall-Scott Motor Car Company, a manufac-

turer of a well-known engine for buses, the Fageol Motor Company of California and the Fageol Motor Company of Ohio, manufacturer of bus bodies. (R. 65a) As respondent admitted in his brief in the Court of Appeals, the plan decided upon was to organize a new corporation which was to acquire all the stock of these companies. Active in this plan were the officers of the Hall-Scott Motor Car Company, E. J. Hall, B. C. Scott and L. S. Scott. Mr. Hall was to be Vice President of the new company in charge of Engineering and Production and all were to have a large stock interest in the new company. Mr. F. R. Fageol, main stockholder of Ohio Fageol, was to be the Vice President in charge of Sales of the new company. The details of the previously made plan were set out in a memo dated September 1, 1925 (before the Hall-Scott stock was bought), which was attached to the minutes of a meeting of the Brill Board of Directors dated September 8, 1925 and read in part as follows (R. 39a-41-a):

> "The American Car & Foundry Company and The J. G. Brill Company have been working for some time to arrange a consolidation between the Hall-Scott Motor Car Company, Incorporated, of Berkeley, California, builders of the well-known Hall-Scott engine and the Fageol Companies (Fageol Motor Company of California, Oakland, California and Fageol Motors Company of Ohio, Kent, Ohio) who have had exclusive right to use this engine in busses built by them.
>
> "To enable such a consolidation to be made, the Car Companies are willing to invest at least $3,500,000.00 in a new consolidated company.
>
> "It is proposed to form a new company to be called the Fageol-Hall-Scott Company (or some other appropriate name) having an authorized capital stock of $10,000,000.00 preferred stock and 150,000 shares of common stock of no par value.
>
> "The car builders have purchased the control (66 2/3%) of the Hall-Scott Company, practically all the remaining stock being retained by Col. E. J. Hall. The Car builders have also arranged with the Board

of Directors of the Fageol Motor Company of California—subject to ratification by the stockholders—to exchange the stock of the new company to be formed, for the stock of the old company. The basis of this exchange has been unanimously approved by the Board of Directors of the Fageol Motor Company of California. It is expected that the same basis of exchange of stock will be arranged for with the Fageol Motors Company of Ohio in which Company The J. G. Brill Company is now a stockholder."

The major steps in the acquisition of the stock of each of these companies were as follows:

(1) On August 28, 1925, officers of American Car & Foundry Company and Brill Company submitted to the directors of Fageol California a proposition for the consolidation of Fageol California and Hall-Scott through the formation of a new corporation. The proposition was accepted by the directors of Fageol California subject to the approval of two-thirds of the stockholders of that company. (R. 66a)

(2) On August 29, 1925, American Car and Foundry Company and Brill Company entered into an agreement with E. J. Hall, B. C. Scott and L. S. Scott for the purchase of 667 shares of stock of Hall Scott out of a total 1000 shares outstanding at the rate of $4,500 per share. (R. 66a)

(3) On October 15, 1925, the owners of 2,470 shares of preferred stock (4,553 outstanding) and 6,974 shares of common stock (10,486 oustanding) of Fageol Ohio submitted to Brill an offer with respect to the exchange of stock of Fageol stock for stock in a new corporation to be organized. (R. 68a)

(4) On October 31, 1925, pursuant to the agreement of August 29, 1925, American Car & Foundry Securities Co., a wholly-owned subsidiary of American Car & Foundry Co., paid the sum of $2,501,962.50 to the shareholders of Hall-Scott for 556 shares of its stock and Brill paid the sum of $499,537.50 to the shareholders of Hall-Scott for 111 shares of its stock. The stock acquired was endorsed in blank and was never trans-

ferred on Hall-Scott's books and no new Hall-Scott stock certificates were issued until they were issued to taxpayer. (R. 68a-69a)

(5) On December 23, 1925, there was formed a new corporation, the American Car & Foundry Company (referred to here as taxpayer) pursuant to the plan of Woodin and Curwen. (R. 69a)

(6) At the meeting of the taxpayer's directors held on December 31, 1925, a resolution was passed approving the acquisition of the entire capital stock of Hall-Scott. All of the Hall-Scott stock was delivered to the new corporation on that date. (R. 69a)

(7) At a meeting of the taxpayer's directors held on December 31, 1925, a resolution was passed accepting the offer of the stockholders of Ohio Fageol to exchange their preferred and common stock for taxpayer's stock. This was done in January 1926. (R. 69a)

(8) The stockholders of California Fageol never approved the proposed consolidation and the stock of California was never acquired. (R. 66a)

This deficiency arose because taxpayer included in its invested capital its investment in Ohio Fageol and Hall-Scott as follows (R. 72a):

Fageol Motors Company	$1,393,445.67
Hall-Scott Motor Car Co.	4,500,000.00
	$5,893,445.67

And in spite of the fact that when American Car & Foundry Securities and Brill bought the Hall-Scott stock for $3,000,000 with the purpose (admitted by respondent) of organizing and transferring that stock to the taxpayer and by carrying out this purpose they clearly invested $3,000,000 in the taxpayer, the Commissioner included in taxpayer's invested capital only the following amounts:

Fageol Motor Company	$454,800
Hall-Scott Motor Car Co.	100,000
	$554,800

The Tax Court sustained the Commissioner on the ground that the transitory ownership of the Hall-Scott stock by American Car and Foundry Securities and Brill was to be treated as a single step and given separate tax consequences. It held, therefore, that the stock of Hall-Scott Company and Fageol Company was acquired by taxpayer in a tax-free exchange. The Court of Appeals for the Third Circuit affirmed.

Specification of Errors To Be Urged.

It is submitted the Court of Appeals erred: (Any of the following three errors will compel reversal)

1. In breaking up the steps of a complicated corporate reorganization and giving each step separate tax effects instead of viewing the reorganization as a whole and in basing its decision on the false assumption that "the contention of the petitioner . . . is necessarily based upon the premise" that the buyers "of the Hall Scott stock . . . did so as promoters for and on behalf of the taxpayer."

2. In failing to apply and completely ignoring the squarely in point decision of this Court in *Helvering* v. *Bashford,* 302 U.S. 454, and under it hold that transitory ownership of the Hall-Scott stock by American Car & Foundry Securities and Brill did not make them parties to a Section 112(b)(5)[1] reorganization.

3. In approving the sole use of the interdependency test to determine whether a complicated corporate reorganization should be treated as a single transaction.

Reasons For Granting The Writ.

1. The decision of the Court of Appeals is directly in conflict with the decision of this Court in *Helvering* v. *Bash-*

[1] Section 203(b)(4) of the Revenue Act of 1926 is involved in this case. However, since 203(b)(4) of the Revenue Act of 1926 is similar to Section 112(b)(5) of the Internal Revenue Code, the latter designation is used throughout the petition.

ford, 302 U.S. 454. Like the *Bashford* case, this case presents the familiar situation where stock of a corporation is purchased by a second corporation for transfer to a third corporation. Also, like the *Bashford* case, this case involves the reorganization provisions of the revenue acts which are generally designed to postpone recognition of gain or loss in situations where the exchange does not effectuate a material change in ownership and where instead there are merely changes in form and not in substance. The *Bashford* case was concerned with the question of whether transitory ownership of stock should be given separate tax effect in determining whether the transfer comes within Section 112(b)(3). This case concerns the question of whether transitory ownership of stock should be given separate tax effect in determining whether the transfer comes within Section 112(b)(5).

In the *Bashford* case, Atlas purchased the stock of Peerless and Union without qualification or reservation of any kind. Atlas then transferred the stock of Peerless and Union to a newly organized subsidiary. The stockholders of Peerless and Union did not participate in the contract or exchange between Atlas and the new company. The government on page 8 of its supplemental brief filed in this Court in that case termed the ownership of the stock of Peerless and Union by Atlas an "intermediate transfer" and stated "that such intermediate transfers may not be regarded as separate and distinct transactions." This Court agreed with this contention and stated:

> "Any direct ownership by Atlas and Peerless, Black Diamond and Union was transitory and without real substance; it was part of a plan which contemplated the immediate transfer of the stock or the assets of both of the three reorganized companies to the new Atlas subsidiary. Hence, under the rule stated, the above distinctions are not of legal significance." (p. 458)

In the Court below, respondent in accord with the uncontradicted evidence admitted on page 2 of his brief that American Car & Foundry Securities and Brill had purchased the Hall-Scott stock "with the purpose of organizing a corporation and of having it acquire all the stock . . . in exchange for issuance of its own stock." Also in his brief in the Court below, on page 18 thereof, respondent stated:

> "Securities Company and Brill Company intended to, and did ultimately, transfer the stock (Hall-Scott) to the taxpayer in exchange for its stock . . ."

It is on the basis of these ultimate facts that petitioner under the rule laid down by this Court in the *Bashford* case is entitled to judgment. All that this Court has to do is to apply the law of the *Bashford* case to these admitted facts. There is of course no need for this Court to go into any question of fact. Petioner's case may rest on the facts as admitted by respondent.

The facts established by the uncontradicted evidence and properly admitted by respondent make it clear that there is a conflict between the decision of the Court below and that of this Court in the *Bashford* case which the decision below ignores. Under the principle laid down by the *Bashford* case the "intermediate transfer" of the Hall-Scott stock to American Car & Foundry Securities and Brill should not be given separate tax effect in determining whether the transfer comes within Section 112(b)(5) as was done by the Court below.

2. The decision below is wrong and produces a glaringly unjust result. The Court of Appeals erred in concluding that the plan relied upon by the two purchasing companies when they purchased the Hall-Scott stock was never carried out. This is shown by the following statement of the crucial facts of the plan made on page 2 of respondent's brief in the Court below under the title "Question Presented":

> "The taxpayer issued its stock to the stockholders of two other corporations in exchange for their shares of stock in such corporations. Some of the transferors (American Car & Foundry Securities and Brill) had previously purchased some of the stock with the purpose of organizing a corporation and of having it acquire all the stock in both corporations in exchange for the issuance of its own stock. The sellers of the stock, however, were not parties to this plan." (names "American Car & Foundry Securities and Brill" inserted)

Where the Court of Appeals become confused was in including in the crucial facts of the plan, upon which the decision depends, the fact that the acquisition of the California Fageol stock was never carried out, which is irrelevant to the issue.

Petitioner is content to rest on the quoted admission of the crucial facts in the case as made by respondent. Respondent's statement makes it plain that the transitory ownership of the Hall-Scott stock by American Car & Foundry Securities and Brill was a part of a complicated corporate reorganization. As such it may not be regarded as a separate and distinct transaction and given separate tax effect as was done by the Court below.

Also the decision below perverts the purpose and intent of the profits tax law because, as is common knowledge, the theory of the invested capital credit for the excess profits tax is that a corporation is entitled to earn from 5 per cent to 8 per cent of the investment made in the corporation by its stockholders before any of its profits are treated as "excess." When American Car & Foundry Securities and

Brill bought the Hall-Scott stock for $3,000,000 with the purpose (admitted by respondent) of organizing and transferring that stock to the taxpayer and carried out such purpose they clearly invested $3,000,000 in the taxpayer. Yet under the decision, taxpayer is allowed to include in its invested capital only $100,000 for all the Hall-Scott stock acquired by it for $3,000,000. This is grossly unjust. This problem is a continuing one because the new excess profits low contains the same provision.

3. A constantly arising issue of considerable importance in the administration of the income tax law is raised by the present case.[1] This case like innumerable others involves the question of whether a series of steps is to be treated as one transaction or broken up into its several elements and each be given separate tax effects. Complicated corporate reorganizations are almost always effected in a number of steps. Almost always one step considered by itself complies with the tax-free exchange provision but the whole transaction does not. The question always arises whether the reorganization must be viewed as a whole or as a series of separate transactions. This Court has held they should be viewed as one transaction. *Helvering* v. *Southwest Co.*, 315 U.S. 199 at p. 200. A rule allowing courts below arbitrary carte blanche to treat such reorganizations either as one or separate transactions will give these cases the character of a roulette lottery.

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[1] At the present time there is pending before this Court two petitions for certiorari involving the question whether two or more steps are to to be considered one transaction: **S. Klein on the Square, Inc. v. Commissioner,** No. 152, and **Kimbell-Diamond Milling Company v. Commissioner,** No. 196. Other petitions for certiorari involving this same question previously filed are **American Bantam Car Company v. Commissioner,** filed on Feb. 10, 1950, and **National Bank of Commerce in Memphis v. United States,** filed on June 30, 1950. Both the latter petitions were denied.

The body of case law on the subject of "step transactions" has been described as "chaotic" and a "morass" and should be clarified by this Court.

Wherefore, your petitioners respectfully pray that a writ of certiorari should be granted.

All of which is respectfully submitted,

JOHN E. HUGHES
JOHN W. HUGHES
HAROLD R. BURNSTEIN

APPENDIX.

INTERNAL REVENUE CODE:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * *

(26 U.S.C. 1946 ed., Sec. 113.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 203. * * *

(b) * * *

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such cor-

poration, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

Treasury Regulations 110, promulgated under the Internal Revenue Code:

Sec. 33.31. *Bases of Tax Computation.*

• • •

(c) [as amended by T. D. 5245, 1943 Cum. Bull. 801, T. D. 5327, 1944 Cum. Bull. 424] *Computations.*—

• • •

(2) • • •

• • •

(iv) In the computation of average invested capital (which, under this section, may be a minus amount), the following adjustments shall be made—

(F) With respect to the stock of another member of the affiliated group held with a basis for invested capital purposes determined to be a basis other than cost, there shall be subtracted from equity invested capital otherwise computed an amount equal to such basis adjusted by an amount equal to the adjustments proper under section 115 (1) for determining earnings and profits, except that no adjustment shall be made with respect to—

• • •

(G) In the case of a member of the affiliated group the stock of which is held by other members of such group with a basis for invested capital purposes determined to be a cost basis, there shall be excluded as of the date on which such corporation became a member of the group within the meaning of section 141 (d) of the Code that portion of its equity invested capital attributable to the shares of stock so held • • •

• • •

(13) For the purpose of computing the consolidated average invested capital for the taxable year—

(i) Stock of one member of the affiliated group held by another member of that group at any time during the taxable year shall be determined to be stock held with a basis other than cost if—

• • •

(B) Such stock is held with a basis fixed by reference to its basis in the hands of a preceding owner, but not including—

• • •

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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 367

ACF-BRILL MOTORS COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 63a-82a) is reported at 14 T.C. 263. The opinion of the Court of Appeals (R. 84-91) is reported at 189 F. 2d 704.

JURISDICTION

The judgment of the Court of Appeals was entered on June 7, 1951. (R. 92.) A petition for rehearing (R. 93-98) was filed on June 21, 1951, and was denied on July 11, 1951 (R. 99). A petition for a writ of certiorari was filed on October 4,

1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

The taxpayer issued its stock to the stockholders of two other corporations in exchange for their shares of stock in such corporations. Some of the transferors had previously purchased some of that stock with the purpose of organizing a corporation and of having it acquire all the stock in both corporations in exchange for the issuance of its own stock. The sellers of the stock, however, were not parties to this plan.

The question is whether the taxpayer acquired the stock of these two corporations in a tax-free exchange under Section 203 (b)(4) and (h)(1)(A) of the Revenue Act of 1926.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations are set forth in the Appendix, *infra*, pp. 13-17.

STATEMENT

In 1925, the officers of the American Car & Foundry Company (called American Car) and J. G. Brill Company (called Brill), being convinced that their business of manufacturing railroad cars and equipment was on the down grade, demonstrated interest in the bus manufacturing business, and commenced activities to procure an enterprise of that kind. In June of that year, they instituted negotiations to acquire the assets

of, or the controlling interest in, the Hall-Scott Company, The Fageol Motor Company of California, and the Fageol Motor Company of Ohio. (R. 65a.) On August 28, 1925, they submitted to the directors of Fageol of California, a proposition for the consolidation of that company and Hall-Scott through the formation of a new corporation. This proposition, which was accepted by California Fageol's directors, was never carried out because not approved by its stockholders. (R. 66a.)

On August 29, 1925, American Car and Brill companies entered into an agreement with three individual stockholders of Hall-Scott Company to purchase from them 667 shares of that company's stock (out of a total of 1,000 outstanding shares) at the rate of $4,500 per share. (R. 66a.) That agreement was executed on October 31, 1925, when a subsidiary of American Car, American Car & Foundry Securities Company (called Securities) paid for the Hall-Scott stock and acquired it from those stockholders. (R. 68a-69a.)

On October 15, 1925, the majority stockholders of Fageol of Ohio (which will be called Fageol) submitted an offer to Brill Company with respect to the exchange of their stock for the stock in a new corporation to be organized. (R. 68a.)

On December 23, 1925, the taxpayer was formed as a corporation. At a meeting of its board of directors on December 31, 1925, a resolution was

passed accepting the offer of the stockholders of Fageol to exchange their preferred and common stock for common stock of the taxpayer. This was carried out in January, 1926. At the meeting of December 31, 1925, the taxpayer's directors also approved the acquisition of all the common stock of Hall-Scott Company in exchange for designated shares of common and preferred stock of the taxpayer. (R. 69a.) These exchanges were carried out in January, 1926, when the then stockholders of Hall-Scott (including Securities and Brill companies) and the stockholders of Fageol received stock in the taxpayer in exchange for their stock in Hall-Scott and in Fageol. (R. 70a-72a.)

In determining the amount of equity invested capital to be used in a consolidated return for excess profits tax purposes, the Commissioner ruled that the taxpayer had acquired the Hall-Scott and Fageol stock in a tax-free exchange, so that that stock was held on an other than cost basis. This determination was sustained by the Tax Court (R. 74a-79a) and by the Court of Appeals (R. 84-91).

ARGUMENT

1. The decision below is correct. The immediate issue is whether the taxpayer acquired the stock of two subsidiary corporations (Hall-Scott Company and Fageol Company) in a tax-free exchange, with the result that the stock of those companies would be held by the taxpayer with a tax basis

which would not be cost.[1] The Court of Appeals, sustaining the Tax Court, held that the stock was acquired by the taxpayer in a transaction in which no gain or loss was recognized under Section 203 (b)(4) and (h)(1)(A) of the Revenue Act of 1926 (Appendix, *infra,* pp. 14-15), the stock, consequently, having a basis other than cost under Section 113 (a)(7) and (8), Internal Revenue Code (Appendix, *infra,* pp. 13-14). Consideration of the relevant circumstances makes it evident that the proper result has been reached.

Shortly after its organization, the taxpayer acquired all the stock of the Hall-Scott and Fageol companies by issuing its own stock in exchange to the then stockholders of both corporations. The

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[1] The ultimate issue concerns the proper amount of equity invested capital to be included in a consolidated corporate return for excess profits tax purposes. If, as held by the courts below, the stock was acquired in a tax-free exchange so as to be held with a basis "other than cost," it is perfectly plain that the Commissioner and the Tax Court made the proper computation of equity invested capital under Treasury Regulations 110, Section 33.31 (c)(2)(iv)(F) and (G), and (13)(i)(B) (Appendix, *infra,* pp. 15-17), and the taxpayer has never before contended otherwise.

While it is now asserted (Pet. 10-11) that the result reached by the decision below contravenes the intent of the excess profits tax law, it is clear that the only real controversy centers on the tax effect in 1926 of the transaction in which the taxpayer acquired the stock of these subsidiaries; once it is determined that the basis of that stock is other than cost, the computation of equity invested capital in the consolidated return is reduced to a mathematical computation, the effect of which is to include in consolidated equity invested capital the subsidiary's original invested capital and the accumulated earnings to the beginning of the taxable year, in place of the parent's investment in the subsidiary's stock. See II Montgomery's *Federal Taxes on Corporations and Partnerships* (1946-1947), pp. 747-756.

transferors of the Hall-Scott and Fageol stock thereupon became the stockholders in control of the taxpayer; the stock interest which they received in the taxpayer as a consequence of this exchange was substantially in proportion to their previous interests in Hall-Scott and Fageol. (R. 69a-72a.) This exchange did not result in taxable gain or loss for it fits the precise language of Section 203 (b)(4) of the 1926 Act as a transfer of "property * * * to a corporation by one or more persons solely in exchange for stock or securities in such corporation * * *." It was also a tax-free "reorganization" under Section 203 (h) (1) (A) of that Act as "the acquisition by one corporation of at least a majority" of all classes of stock "of another corporation."

The taxpayer has abandoned (Pet. 7) its principal argument below, namely, that the transferors (Securities and Brill companies) who had exchanged 667 shares of Hall-Scott stock for the taxpayer's stock had, in reality, previously purchased the Hall-Scott stock on behalf of the taxpayer as its promoters. (R. 77a-78a, 87-88.) The exact reasons on which the taxpayer now relies for the continued contention that a taxable rather than a non-taxable exchange took place in 1926, are not easily ascertainable from the petition. The argument expressly advanced is that the exchange by Securities and Brill companies of their Hall-Scott stock for the taxpayer's stock should be ignored

(Pet. 7-10); the unexpressed assumption seems to be that the original Hall-Scott stockholders who sold their 667 shares to Securities and Brill in 1925, should somehow be considered as having sold that stock to the taxpayer for cash in 1926, and that the stock which the taxpayer actually issued to Securities and Brill for the Hall-Scott stock should either be ignored or considered as issued for something else. This, we further surmise, is supposed to make the tax-free provisions of the statute inapplicable by opening the way for the contention that there would have been no compliance with the control, proportionate interest, and continuity of interest requirements of the applicable statutory sections.[2]

The courts below, however, were correct in holding that there was no basis for ignoring the transactions which took place or for completely altering the substance of what the parties did. Whether Securities and Brill were actually the parties which transferred the 667 shares of Hall-Scott stock to the taxpayer in exchange for the taxpayer's stock, as the Court of Appeals observed (R. 89), was

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[2] Section 203 (b) (4) of the 1926 Act requires that the transferors of the property (the Hall-Scott and Fageol stock here) be in control of the transferee immediately after the exchange, and that the stock and securities received by them be substantially in proportion to their previous interest in the property transferred. Also, to constitute a tax-free exchange under Section 203 (h) (1), the original stockholders must possess a continuity of interest in the business venture. *Pinellas Ice Co.* v. *Commissioner*, 287 U.S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378; *LeTulle* v. *Scofield*, 308 U.S. 415.

basically a matter for determination by the fact-finder. Cf. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451. The Tax Court's conclusion that they were the transferors, both in fact and in substance, was certainly permitted if, indeed, it was not compelled by the record.

The Tax Court was not required to reach any different conclusion simply because Securities and Brill, motivated by a desire to control an integrated bus manufacturing business, may have purchased these Hall-Scott shares with the general purpose of ultimately transferring that stock and the stock in other companies to a new corporation. As the court below pointed out (R. 90), there was, at most, only a general plan, the details of which changed from time to time, and the general aspects of the plan existing when the stock was purchased were never carried out completely. The court below also agreed (R. 89-91) with the Tax Court that the transfer of the stock to the taxpayer was not an indispensable part of the plan with which the stock was purchased and that, as such, there was no reason for disregarding this or any other aspect of the transactions which took place.

Furthermore, whatever plan was being entertained by Securities and Brill when they purchased these shares, they were under no obligation to the sellers of the Hall-Scott stock, to each other, or to

the taxpayer to transfer that stock to the taxpayer. Instead, they became vested with full ownership when they bought the stock, free to do with it as they pleased; the sellers, consequently, were complete strangers to anything that Securities and Brill did thereafter. As a result, there is no basis for any conclusion that the original Hall-Scott stockholders sold their shares, not to Securities and Brill, but to the taxpayer corporation which was not even in existence at the time of the sale. The tax consequences, accordingly, must be determined by the circumstances that actually existed. *Founders General Co.* v. *Hoey,* 300 U.S. 268.

The taxpayer is mistaken in contending (Pet. 7-9) that *Helvering* v. *Bashford,* 302 U.S. 454, requires a different result. That case not only involved an altogether different statutory problem, but it presented completely dissimilar facts. There, Atlas Company, desiring to eliminate competition from three other concerns (Peerless, Union, and Black Diamond) conceived the plan of consolidating them in a single corporation which it would control. The stockholders of the competing corporations agreed to give up their stock, which was to be transferred to the new corporation, in exchange for some stock in the new corporation, some of Atlas' stock, and cash which Atlas was to supply to the new corporation. Atlas, in turn, for the cash which it supplied and its own stock which it transferred, was to receive all the pre-

ferred stock and a majority of the common stock of the new corporation.

To the extent that the stockholders of the old corporations received stock from the new corporation in exchange for their old shares of stock, the exchange was conceded to be tax-free. To the extent that they also received shares of Atlas' stock, it was held, following *Groman* v. *Commissioner,* 302 U.S. 82, that a tax-free exchange was not involved because Atlas was not a party to the reorganization.

In an attempt to avoid the *Groman* case, it was argued by the taxpayer in *Bashford* that Atlas was a party to the reorganization because it had exchanged stock which it owned in the competing companies for stock in the new company. Although the record in that case was fairly clear that Atlas had not even possessed momentary, technical title in the stock of the competing companies, this Court dismissed the argument because, in any event (p. 458) "Any direct ownership" of that stock by Atlas "was transitory and without real substance * * *." This conclusion plainly followed from the fact that there had been binding agreements with the old stockholders that their stock in, and the assets of, the competing companies would be transferred to the new corporation.[3]

[3] The taxpayer is also in error in asserting (Pet. 8) that Atlas purchased the stock "without qualification or reservation of any kind" and that the stockholders of the competing companies "did not participate in the contract or exchange between Atlas and the new company."

The situation in the *Bashford* case is thus different from the present case in every essential respect. Atlas' ownership, if any, was transitory and devoid of substance for, being obligated to transfer the stock to the new corporation, it never was free to exercise the rights of an owner. Here, as we have seen, Securities and Brill acquired ownership in every sense of that word, there being no strings or other conditions attached to their acquisition of the Hall-Scott stock. Further, in the *Bashford* case, the old stockholders had the contractual right to have their stock transferred to the new corporation so that, even if Atlas did possesss momentary title, it lacked substantial ownership, for it was a mere conduit to pass title to the new corporation, the old stockholders being the true transferors. See also *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609. Here, however, the old stockholders had no control over the shares of stock which they sold, and had no connection with the subsequent transfer of that stock to the new corporation. They, consequently, could not be viewed as having transferred the stock to the taxpayer.

Thus, even if there be overlooked the completely different problems presented by the two cases, the *Bashford* decision, where the fact situation is diametrically opposed to that of this case, does not require a contrary result.

2. The taxpayer does not contend that the deci-

sion below conflicts with that in any other circuit. While it is claimed (Pet. 7-9) that the decision here is opposed by *Helvering* v. *Bashford,* 302 U.S. 454, we have already demonstrated that the two decisions are completely harmonious.

CONCLUSION

The decision below is correct. There is no conflict in decisions. No other reasons appear which would warrant further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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NOVEMBER, 1951.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to Corporation.*—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 203. * * *

(b) * * *

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more

persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or * * *

Treasury Regulations 110, promulgated under the Internal Revenue Code:

Sec. 33.31. *Bases of Tax Computation.*

* * * * *

(c) [as amended by T. D. 5245, 1943 Cum. Bull. 801, and T. D. 5327, 1944 Cum. Bull. 424] *Computations.*—

* * * * *

(2) * * *

* * * * *

(iv) In the computation of average invested capital (which, under this section, may be a minus amount), the following adjustments shall be made—

* * * * *

(F) With respect to the stock of another member of the affiliated group held with a basis for invested capital purposes determined to be a basis other than cost, there shall be subtracted from equity invested capital otherwise computed an amount equal to such basis adjusted by an amount equal to the adjustments proper under section 115 (l) for determining earnings and profits, except that no adjustment shall be made with respect to—

* * * * *

(G) In the case of a member of the affiliated group the stock of which is held by other members of such group with a basis for invested capital purposes determined to be a cost basis, there shall be excluded as of the date on which such corporation became a member of the group within the meaning of section 141 (d) of the Code that portion of its equity invested capital attributable to the shares of stock so held * * *

* * * * *

(13) For the purpose of computing the consolidated average invested capital for the taxable year—

(i) Stock of one member of the affiliated group held by another member of the group at any time during the taxable year shall be determined to be stock held with a basis other than cost if—

* * * * *

(B) Such stock is held with a basis fixed by reference to its basis in the hands of a preceding owner, but not including—

* * * * *

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